

Difficult, yes, but just the first step forward

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NEW YORK — The global financial crisis is a wake-up call to modernize Canada's regulatory system.

The crisis is proof positive that a global financial market exists. The fact that higher default rates in subprime mortgages in the United States could lead to a worldwide financial meltdown demonstrates that our national markets are inextricably linked.

In addition, the geographic scope of the crisis exposed the distance to which investors, companies and financial institutions were willing to travel to secure higher returns, cheaper capital and greater profits. Such capital mobility means that all countries, including Canada, are competing head-to-head to be centres of capital formation.

The crisis also forced us to become aware of the complexity of our financial institutions. No longer can financial institutions be categorized purely by the type of products they provide. Instead, many financial institutions have become hybrid entities: part commercial bank, part hedge fund, part insurance provider, part broker-dealer and part investment adviser. The largest institutions operate across markets and borders and on a size and scale that dwarf the capabilities of local regulators.

Most alarmingly, the crisis revealed that many regulators were woefully unprepared to address the causes of a systemic financial crisis. In some countries, regulators acted like the three blind men and the elephant - each regulator focused on its particular corner of the financial industry, leaving no one with a comprehensive picture of the entire market.

Canada's regulatory system consequently faces three key challenges. Since financial activity is now global, Canada's system must be prepared to regulate the Canadian markets within a framework of co-operative arrangements with foreign regulators. It also must promote more vigorously Canada's interests in the setting of international regulatory standards.

To better supervise financial conglomerates, it needs to regulate more comprehensively all aspects of these institutions.

To make the Canadian financial markets more attractive, it needs to balance the need for new regulation against the cost of such regulation on market participants.

To meet these challenges, Canada must not only implement, but go beyond, the recommendations of the Expert Panel on Securities Regulation in Canada, whose report was released Jan. 12.

First, responsibility for the regulation of all sectors of the financial markets, including securities regulation, should be placed in the hands of the federal government. A federal authority will be in the best position to ensure consistent regulatory quality across the nation and to represent Canada's interests in bilateral and multilateral negotiations on financial standards.

Second, regulatory power should be consolidated in the hands of a smaller number of agencies to allow for broader and more comprehensive regulation of financial institutions. For example, regulatory agencies should be reorganized into three broad groups: a set of regulators that focus on prudential regulation (i.e., regulation pertaining to the soundness of an institution), another set focusing on business conduct regulation (i.e., regulation pertaining to consumer, investor and depositor protection), and a possible third set focused on monitoring systemic threats to the market.

Third, Canadian regulators should build upon the Expert Panel's recommendation for securities regulation and introduce principles-based and proportionate-based regulation in all areas of financial regulation. If implemented properly, such approaches, which emphasize flexibility and results as opposed to rigid rules and check-the-box lists, can lower the cost of regulatory compliance while still ensuring an appropriate level of protection for Canadian investors and consumers.

Canada's challenge is not unique. Last year, the U.S. Treasury Department identified comparable flaws in the U.S. system, and regulatory reform will be a priority of the Obama administration. Similarly Australia, France, Germany, the Netherlands and Britain have all attempted in recent years to restructure their regulatory systems along the lines recommended above. Canada should not fall behind.

Fortunately, Canada is in an excellent position to put into place these reforms. The basic framework for single prudential and business conduct regulators already exists in the forms of the Office of the Superintendent of Financial Institutions and the

Financial Consumer Agency of Canada. These agencies should be given new powers to regulate all financial markets, including the securities markets, and be tasked with representing Canada in all international negotiations pertaining to financial regulation.

The fact that Canada has weathered the financial crisis better than its main economic partners does not mean it can ignore the lessons of the crisis. Swift implementation of the Expert Panel's recommendations is an important first step. But the country urgently needs to go further and update its entire financial regulatory system to ensure the safety and future success of Canada's financial markets.

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70 YEARS OF STUDY

The terminology differs - single, common, Canadian, national or federal - but the conclusion of virtually every study has been the same:

1935: Royal Commission on Price Spreads calls for a national securities presence.

1964: The Porter Commission recommends uniform securities regulation either through a national agency with federal legislation, or through a uniform statute creating a single agency.

1967: The Ontario Securities Commission proposes that the federal and provincial governments jointly delegate their authority to a federally created Canadian Securities Commission.

1979: Proposals for a Securities Market Law for Canada recommends establishment of a Canadian securities commission and prepares a draft federal statute which provides for federal legislative jurisdiction excluding intraprovincial matters.

1994: Federal government proposal to create a Canadian Securities Commission pursuant to federal legislation, excluding intraprovincial matters and provinces not opting in.

2003: Wise Persons Committee recommends a Canadian Securities Commission, preferably in a federal-provincial scheme.

2006: The Task Force to Modernize Securities Regulation recommends management of enforcement on a national basis in either a unified or harmonized approach to regulation.

2006: The Crawford Panel recommends a common securities regulator administering a common securities act on behalf of participating governments.

2009: The Expert Panel on Securities Regulation urges the provinces to join a national securities regulator.

Staff, Expert Panel

on Securities Regulation

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